

will not be issued unless the taxpayer establishes to the satisfaction of the IRS that there is not a significant risk of different parties to the transaction taking inconsistent positions, for Federal tax purposes, with respect to the applicability of the final regulations to the transaction. The sixth sentence of paragraph (e)(1)(i) of this section, the last sentence of paragraph (e)(1)(ii) of this section, paragraph (e)(3) of this section, paragraph (e)(6) of this section, and *Example 10* of paragraph (e)(8) of this section apply to transactions occurring after December 12, 2008.

(ii) *COI measurement date.* Paragraph (e)(2) of this section applies to transactions occurring pursuant to binding contracts entered into after December 19, 2011. For transactions entered into after March 19, 2010, and occurring pursuant to binding contracts entered into on or before December 19, 2011, the parties to the transaction may elect to apply the provisions of § 1.368-1T as contained in 26 CFR, Part 1, §§ 1.301-1.400, revised as of April 1, 2009. However, the target corporation, the issuing corporation, the controlling corporation of the acquiring corporation if stock thereof is provided as consideration in the transaction, and any direct or indirect transferee of transferred basis property from any of the foregoing, may not elect to apply the provisions of § 1.368-1T as contained in 26 CFR, Part 1, §§ 1.301-1.400, revised as of April 1, 2009, unless all such taxpayers elect to apply such provisions. This election requirement will be satisfied if none of the specified parties adopts inconsistent treatment. For transactions entered into on or before March 19, 2010, see § 1.368-1T as contained in 26 CFR, Part 1, §§ 1.301-1.400, revised as of April 1, 2009.

[T.D. 6500, 25 FR 11607, Nov. 26, 1960]

EDITORIAL NOTE: For FEDERAL REGISTER citations affecting § 1.368-1, see the List of CFR Sections Affected, which appears in the Finding Aids section of the printed volume and at [www.fdsys.gov](http://www.fdsys.gov).

**§ 1.368-2 Definition of terms.**

(a) The application of the term *reorganization* is to be strictly limited to the specific transactions set forth in section 368(a). The term does not embrace the mere purchase by one cor-

poration of the properties of another corporation. The preceding sentence applies to transactions occurring after January 28, 1998, except that it does not apply to any transaction occurring pursuant to a written agreement which is binding on January 28, 1998, and at all times thereafter. If the properties are transferred for cash and deferred payment obligations of the transferee evidenced by short-term notes, the transaction is a sale and not an exchange in which gain or loss is not recognized.

(b)(1)(i) *Definitions.* For purposes of this paragraph (b)(1), the following terms shall have the following meanings:

(A) *Disregarded entity.* A disregarded entity is a business entity (as defined in § 301.7701-2(a) of this chapter) that is disregarded as an entity separate from its owner for Federal income tax purposes. Examples of disregarded entities include a domestic single member limited liability company that does not elect to be classified as a corporation for Federal income tax purposes, a corporation (as defined in § 301.7701-2(b) of this chapter) that is a qualified REIT subsidiary (within the meaning of section 856(i)(2)), and a corporation that is a qualified subchapter S subsidiary (within the meaning of section 1361(b)(3)(B)).

(B) *Combining entity.* A combining entity is a business entity that is a corporation (as defined in § 301.7701-2(b) of this chapter) that is not a disregarded entity.

(C) *Combining unit.* A combining unit is composed solely of a combining entity and all disregarded entities, if any, the assets of which are treated as owned by such combining entity for Federal income tax purposes.

(ii) *Statutory merger or consolidation generally.* For purposes of section 368(a)(1)(A), a statutory merger or consolidation is a transaction effected pursuant to the statute or statutes necessary to effect the merger or consolidation, in which transaction, as a result of the operation of such statute or statutes, the following events occur simultaneously at the effective time of the transaction—

(A) All of the assets (other than those distributed in the transaction)

and liabilities (except to the extent such liabilities are satisfied or discharged in the transaction or are non-recourse liabilities to which assets distributed in the transaction are subject) of each member of one or more combining units (each a transferor unit) become the assets and liabilities of one or more members of one other combining unit (the transferee unit); and

(B) The combining entity of each transferor unit ceases its separate legal existence for all purposes; provided, however, that this requirement will be satisfied even if, under applicable law, after the effective time of the transaction, the combining entity of the transferor unit (or its officers, directors, or agents) may act or be acted against, or a member of the transferee unit (or its officers, directors, or agents) may act or be acted against in the name of the combining entity of the transferor unit, provided that such actions relate to assets or obligations of the combining entity of the transferor unit that arose, or relate to activities engaged in by such entity, prior to the effective time of the transaction, and such actions are not inconsistent with the requirements of paragraph (b)(1)(ii)(A) of this section.

(iii) *Examples.* The following examples illustrate the rules of paragraph (b)(1) of this section. In each of the examples, except as otherwise provided, each of R, V, Y, and Z is a C corporation. X is a domestic limited liability company. Except as otherwise provided, X is wholly owned by Y and is disregarded as an entity separate from Y for Federal income tax purposes. The examples are as follows:

*Example 1. Divisive transaction pursuant to a merger statute.* (i) *Facts.* Under State W law, Z transfers some of its assets and liabilities to Y, retains the remainder of its assets and liabilities, and remains in existence for Federal income tax purposes following the transaction. The transaction qualifies as a merger under State W corporate law.

(ii) *Analysis.* The transaction does not satisfy the requirements of paragraph (b)(1)(ii)(A) of this section because all of the assets and liabilities of Z, the combining entity of the transferor unit, do not become the assets and liabilities of Y, the combining entity and sole member of the transferee unit. In addition, the transaction does not satisfy the requirements of paragraph (b)(1)(ii)(B) of this section because the sepa-

rate legal existence of Z does not cease for all purposes. Accordingly, the transaction does not qualify as a statutory merger or consolidation under section 368(a)(1)(A).

*Example 2. Merger of a target corporation into a disregarded entity in exchange for stock of the owner.* (i) *Facts.* Under State W law, Z merges into X. Pursuant to such law, the following events occur simultaneously at the effective time of the transaction: all of the assets and liabilities of Z become the assets and liabilities of X and Z's separate legal existence ceases for all purposes. In the merger, the Z shareholders exchange their stock of Z for stock of Y.

(ii) *Analysis.* The transaction satisfies the requirements of paragraph (b)(1)(ii) of this section because the transaction is effected pursuant to State W law and the following events occur simultaneously at the effective time of the transaction: all of the assets and liabilities of Z, the combining entity and sole member of the transferor unit, become the assets and liabilities of one or more members of the transferee unit that is comprised of Y, the combining entity of the transferee unit, and X, a disregarded entity the assets of which Y is treated as owning for Federal income tax purposes, and Z ceases its separate legal existence for all purposes. Accordingly, the transaction qualifies as a statutory merger or consolidation for purposes of section 368(a)(1)(A).

*Example 3. Merger of a target S corporation that owns a QSub into a disregarded entity.* (i) *Facts.* The facts are the same as in *Example 2*, except that Z is an S corporation and owns all of the stock of U, a QSub.

(ii) *Analysis.* The deemed formation by Z of U pursuant to § 1.1361-5(b)(1) (as a consequence of the termination of U's QSub election) is disregarded for Federal income tax purposes. The transaction is treated as a transfer of the assets of U to X, followed by X's transfer of these assets to U in exchange for stock of U. See § 1.1361-5(b)(3) *Example 9*. The transaction will, therefore, satisfy the requirements of paragraph (b)(1)(ii) of this section because the transaction is effected pursuant to State W law and the following events occur simultaneously at the effective time of the transaction: all of the assets and liabilities of Z and U, the sole members of the transferor unit, become the assets and liabilities of one or more members of the transferee unit that is comprised of Y, the combining entity of the transferee unit, and X, a disregarded entity the assets of which Y is treated as owning for Federal income tax purposes, and Z ceases its separate legal existence for all purposes. Moreover, the

deemed transfer of the assets of U in exchange for U stock does not cause the transaction to fail to qualify as a statutory merger or consolidation. See § 368(a)(2)(C). Accordingly, the transaction qualifies as a statutory merger or consolidation for purposes of section 368(a)(1)(A).

*Example 4. Triangular merger of a target corporation into a disregarded entity.* (i) *Facts.* The facts are the same as in *Example 2*, except that V owns 100 percent of the outstanding stock of Y and, in the merger of Z into X, the Z shareholders exchange their stock of Z for stock of V. In the transaction, Z transfers substantially all of its properties to X.

(ii) *Analysis.* The transaction is not prevented from qualifying as a statutory merger or consolidation under section 368(a)(1)(A), provided the requirements of section 368(a)(2)(D) are satisfied. Because the assets of X are treated for Federal income tax purposes as the assets of Y, Y will be treated as acquiring substantially all of the properties of Z in the merger for purposes of determining whether the merger satisfies the requirements of section 368(a)(2)(D). As a result, the Z shareholders that receive stock of V will be treated as receiving stock of a corporation that is in control of Y, the combining entity of the transferee unit that is the acquiring corporation for purposes of section 368(a)(2)(D). Accordingly, the merger will satisfy the requirements of section 368(a)(2)(D).

*Example 5. Merger of a target corporation into a disregarded entity owned by a partnership.* (i) *Facts.* The facts are the same as in *Example 2*, except that Y is organized as a partnership under the laws of State W and is classified as a partnership for Federal income tax purposes.

(ii) *Analysis.* The transaction does not satisfy the requirements of paragraph (b)(1)(ii)(A) of this section. All of the assets and liabilities of Z, the combining entity and sole member of the transferor unit, do not become the assets and liabilities of one or more members of a transferee unit because neither X nor Y qualifies as a combining entity. Accordingly, the transaction cannot qualify as a statutory merger or consolidation for purposes of section 368(a)(1)(A).

*Example 6. Merger of a disregarded entity into a corporation.* (i) *Facts.* Under State W law, X merges into Z. Pursuant to such law, the following events occur simultaneously at the effective time of the transaction: all of the assets and liabilities of X (but not the assets and liabilities of Y other than those of X) become the assets and liabilities of Z and X's separate legal existence ceases for all purposes.

(ii) *Analysis.* The transaction does not satisfy the requirements of paragraph (b)(1)(ii)(A) of this section because all of the assets and liabilities of a transferor unit do

not become the assets and liabilities of one or more members of the transferee unit. The transaction also does not satisfy the requirements of paragraph (b)(1)(ii)(B) of this section because X does not qualify as a combining entity. Accordingly, the transaction cannot qualify as a statutory merger or consolidation for purposes of section 368(a)(1)(A).

*Example 7. Merger of a corporation into a disregarded entity in exchange for interests in the disregarded entity.* (i) *Facts.* Under State W law, Z merges into X. Pursuant to such law, the following events occur simultaneously at the effective time of the transaction: all of the assets and liabilities of Z become the assets and liabilities of X and Z's separate legal existence ceases for all purposes. In the merger of Z into X, the Z shareholders exchange their stock of Z for interests in X so that, immediately after the merger, X is not disregarded as an entity separate from Y for Federal income tax purposes. Following the merger, pursuant to § 301.7701-3(b)(1)(i) of this chapter, X is classified as a partnership for Federal income tax purposes.

(ii) *Analysis.* The transaction does not satisfy the requirements of paragraph (b)(1)(ii)(A) of this section because immediately after the merger X is not disregarded as an entity separate from Y and, consequently, all of the assets and liabilities of Z, the combining entity of the transferor unit, do not become the assets and liabilities of one or more members of a transferee unit. Accordingly, the transaction cannot qualify as a statutory merger or consolidation for purposes of section 368(a)(1)(A).

*Example 8. Merger transaction preceded by distribution.* (i) *Facts.* Z operates two unrelated businesses, Business P and Business Q, each of which represents 50 percent of the value of the assets of Z. Y desires to acquire and continue operating Business P, but does not want to acquire Business Q. Pursuant to a single plan, Z sells Business Q for cash to parties unrelated to Z and Y in a taxable transaction, and then distributes the proceeds of the sale pro rata to its shareholders. Then, pursuant to State W law, Z merges into Y. Pursuant to such law, the following events occur simultaneously at the effective time of the transaction: all of the assets and liabilities of Z related to Business P become the assets and liabilities of Y and Z's separate legal existence ceases for all purposes. In the merger, the Z shareholders exchange their Z stock for Y stock.

(ii) *Analysis.* The transaction satisfies the requirements of paragraph (b)(1)(ii) of this section because the transaction is effected pursuant to State W law and the following events occur simultaneously at the effective time of the transaction: all of the assets and liabilities of Z, the combining entity and sole member of the transferor unit, become the assets and liabilities of Y, the combining

entity and sole member of the transferee unit, and Z ceases its separate legal existence for all purposes. Accordingly, the transaction qualifies as a statutory merger or consolidation for purposes of section 368(a)(1)(A).

*Example 9. State law conversion of target corporation into a limited liability company.* (i) *Facts.* Y acquires the stock of V from the V shareholders in exchange for consideration that consists of 50 percent voting stock of Y and 50 percent cash. Immediately after the stock acquisition, V files the necessary documents to convert from a corporation to a limited liability company under State W law. Y's acquisition of the stock of V and the conversion of V to a limited liability company are steps in a single integrated acquisition by Y of the assets of V.

(ii) *Analysis.* The acquisition by Y of the assets of V does not satisfy the requirements of paragraph (b)(1)(ii)(B) of this section because V, the combining entity of the transferor unit, does not cease its separate legal existence. Although V is an entity disregarded from its owner for Federal income tax purposes, it continues to exist as a juridical entity after the conversion. Accordingly, Y's acquisition of the assets of V does not qualify as a statutory merger or consolidation for purposes of section 368(a)(1)(A).

*Example 10. Dissolution of target corporation.* (i) *Facts.* Y acquires the stock of Z from the Z shareholders in exchange for consideration that consists of 50 percent voting stock of Y and 50 percent cash. Immediately after the stock acquisition, Z files a certificate of dissolution pursuant to State W law and commences winding up its activities. Under State W dissolution law, ownership and title to Z's assets does not automatically vest in Y upon dissolution. Instead, Z transfers assets to its creditors in satisfaction of its liabilities and transfers its remaining assets to Y in the liquidation stage of the dissolution. Y's acquisition of the stock of Z and the dissolution of Z are steps in a single integrated acquisition by Y of the assets of Z.

(ii) *Analysis.* The acquisition by Y of the assets of Z does not satisfy the requirements of paragraph (b)(1)(ii) of this section because Y does not acquire all of the assets of Z as a result of Z filing the certificate of dissolution or simultaneously with Z ceasing its separate legal existence. Instead, Y acquires the assets of Z by reason of Z's transfer of its assets to Y. Accordingly, Y's acquisition of the assets of Z does not qualify as a statutory merger or consolidation for purposes of section 368(a)(1)(A).

*Example 11. Merger of corporate partner into a partnership.* (i) *Facts.* Y owns an interest in X, an entity classified as a partnership for Federal income tax purposes, that represents a 60 percent capital and profits interest in X. Z owns an interest in X that represents a 40 percent capital and profits interest. Under

State W law, Z merges into X. Pursuant to such law, the following events occur simultaneously at the effective time of the transaction: all of the assets and liabilities of Z become the assets and liabilities of X and Z ceases its separate legal existence for all purposes. In the merger, the Z shareholders exchange their stock of Z for stock of Y. As a result of the merger, X becomes an entity that is disregarded as an entity separate from Y for Federal income tax purposes.

(ii) *Analysis.* The transaction satisfies the requirements of paragraph (b)(1)(ii) of this section because the transaction is effected pursuant to State W law and the following events occur simultaneously at the effective time of the transaction: all of the assets and liabilities of Z, the combining entity and sole member of the transferor unit, become the assets and liabilities of one or more members of the transferee unit that is comprised of Y, the combining entity of the transferee unit, and X, a disregarded entity the assets of which Y is treated as owning for Federal income tax purposes immediately after the transaction, and Z ceases its separate legal existence for all purposes. Accordingly, the transaction qualifies as a statutory merger or consolidation for purposes of section 368(a)(1)(A).

*Example 12. State law consolidation.* (i) *Facts.* Under State W law, Z and V consolidate. Pursuant to such law, the following events occur simultaneously at the effective time of the transaction: all of the assets and liabilities of Z and V become the assets and liabilities of Y, an entity that is created in the transaction, and the existence of Z and V continues in Y. In the consolidation, the Z shareholders and the V shareholders exchange their stock of Z and V, respectively, for stock of Y.

(ii) *Analysis.* With respect to each of Z and V, the transaction satisfies the requirements of paragraph (b)(1)(ii) of this section because the transaction is effected pursuant to State W law and the following events occur simultaneously at the effective time of the transaction: all of the assets and liabilities of Z and V, respectively, each of which is the combining entity of a transferor unit, become the assets and liabilities of Y, the combining entity and sole member of the transferee unit, and Z and V each ceases its separate legal existence for all purposes. Accordingly, the transaction qualifies as the statutory merger or consolidation of each of Z and V into Y for purposes of section 368(a)(1)(A).

*Example 13. Transaction effected pursuant to foreign statutes.* (i) *Facts.* Z and Y are entities organized under the laws of Country Q and classified as corporations for Federal income tax purposes. Z and Y combine. Pursuant to statutes of Country Q the following events occur simultaneously: all of the assets and

liabilities of Z become the assets and liabilities of Y and Z's separate legal existence ceases for all purposes.

(ii) *Analysis.* The transaction satisfies the requirements of paragraph (b)(1)(ii) of this section because the transaction is effected pursuant to statutes of Country Q and the following events occur simultaneously at the effective time of the transaction: all of the assets and liabilities of Z, the combining entity of the transferor unit, become the assets and liabilities of Y, the combining entity and sole member of the transferee unit, and Z ceases its separate legal existence for all purposes. Accordingly, the transaction qualifies as a statutory merger or consolidation for purposes of section 368(a)(1)(A).

*Example 14. Foreign law amalgamation using parent stock.* (i) *Facts.* Z and V are entities organized under the laws of Country Q and classified as corporations for Federal income tax purposes. Z and V amalgamate. Pursuant to statutes of Country Q, the following events occur simultaneously: all the assets and liabilities of Z and V become the assets and liabilities of R, an entity that is created in the transaction and that is wholly owned by Y immediately after the transaction, and Z's and V's separate legal existences cease for all purposes. In the transaction, the Z and V shareholders exchange their Z and V stock, respectively, for stock of Y.

(ii) *Analysis.* With respect to each of Z and V, the transaction satisfies the requirements of paragraph (b)(1)(ii) of this section because the transaction is effected pursuant to Country Q law and the following events occur simultaneously at the effective time of the transaction: all of the assets and liabilities of Z and V, respectively, each of which is the combining entity of a transferor unit, become the assets and liabilities of R, the combining entity and sole member of the transferee unit, with regard to each of the above transfers, and Z and V each ceases its separate legal existence for all purposes. Because Y is in control of R immediately after the transaction, the Z shareholders and the V shareholders will be treated as receiving stock of a corporation that is in control of R, the combining entity of the transferee unit that is the acquiring corporation for purposes of section 368(a)(2)(D). Accordingly, the transaction qualifies as the statutory merger or consolidation of each of Z and V into R, a corporation controlled by Y, and is a reorganization under section 368(a)(1)(A) by reason of section 368(a)(2)(D).

(v) *Effective date—(A) In general.* This paragraph (b)(1) applies to transactions occurring on or after January 23, 2006. For rules regarding statutory mergers or consolidation occurring before January 23, 2006, see § 1.368-2T as contained in 26 CFR part 1, revised April 1, 2005, and § 1.368-2(b)(1) as in effect before

January 24, 2003 (see 26 CFR part 1, revised April 1, 2002).

(B) *Transitional rule.* A taxpayer may elect to apply the provisions of § 1.368-2T(b) as contained in 26 CFR part 1, revised April 1, 2005 (the temporary regulations), instead of the provisions of this paragraph (b), to a transaction that occurs on or after January 23, 2006, pursuant to a written agreement which is (subject to customary conditions) binding on January 22, 2006, and at all times thereafter, or pursuant to a tender offer announced prior to January 23, 2006. However, the combining entity of the transferor unit, the combining entity of the transferee unit, any controlling corporation of the combining entity of the transferee unit if stock thereof is provided as consideration in the transaction, and any direct or indirect transferee of transferred basis property from any of the foregoing, may not elect to apply the provisions of the temporary regulations unless all such taxpayers elect to apply the provisions of the temporary regulations.

(2) In order for the transaction to qualify under section 368(a)(1)(A) by reason of the application of section 368(a)(2)(D), one corporation (the acquiring corporation) must acquire substantially all of the properties of another corporation (the acquired corporation) partly or entirely in exchange for stock of a corporation which is in control of the acquiring corporation (the controlling corporation), provided that (i) the transaction would have qualified under section 368(a)(1)(A) if the merger had been into the controlling corporation, and (ii) no stock of the acquiring corporation is used in the transaction. The foregoing test of whether the transaction would have qualified under section 368(a)(1)(A) if the merger had been into the controlling corporation means that the general requirements of a reorganization under section 368(a)(1)(A) (such as a business purpose, continuity of business enterprise, and continuity of interest) must be met in addition to the special requirements of section 368(a)(2)(D). Under this test, it is not relevant whether the merger into the controlling corporation could have

been effected pursuant to State or Federal corporation law. The term *substantially all* has the same meaning as it has in section 368(a)(1)(C). Although no stock of the acquiring corporation can be used in the transaction, there is no prohibition (other than the continuity of interest requirement) against using other property, such as cash or securities, of either the acquiring corporation or the parent or both. In addition, the controlling corporation may assume liabilities of the acquired corporation without disqualifying the transaction under section 368(a)(2)(D), and for purposes of section 357(a) the controlling corporation is considered a party to the exchange. For example, if the controlling corporation agrees to substitute its stock for stock of the acquired corporation under an outstanding employee stock option agreement, this assumption of liability will not prevent the transaction from qualifying as a reorganization under section 368(a)(2)(D) and the assumption of liability is not treated as money or other property for purposes of section 361(b). Section 368(a)(2)(D) applies whether or not the controlling corporation (or the acquiring corporation) is formed immediately before the merger, in anticipation of the merger, or after preliminary steps have been taken to merge directly into the controlling corporation. Section 368(a)(2)(D) applies only to statutory mergers occurring after October 22, 1968.

(3) For regulations under section 368(a)(2)(E), see paragraph (j) of this section.

(c) In order to qualify as a "reorganization" under section 368(a)(1)(B), the acquisition by the acquiring corporation of stock of another corporation must be in exchange solely for all or a part of the voting stock of the acquiring corporation (or, in the case of transactions occurring after December 31, 1963, solely for all or a part of the voting stock of a corporation which is in control of the acquiring corporation), and the acquiring corporation must be in control of the other corporation immediately after the transaction. If, for example, Corporation X in one transaction exchanges non-voting preferred stock or bonds in addition to all or a part of its voting stock

in the acquisition of stock of Corporation Y, the transaction is not a reorganization under section 368(a)(1)(B). Nor is a transaction a reorganization described in section 368(a)(1)(B) if stock is acquired in exchange for voting stock both of the acquiring corporation and of a corporation which is in control of the acquiring corporation. The acquisition of stock of another corporation by the acquiring corporation solely for its voting stock (or solely for voting stock of a corporation which is in control of the acquiring corporation) is permitted tax-free even though the acquiring corporation already owns some of the stock of the other corporation. Such an acquisition is permitted tax-free in a single transaction or in a series of transactions taking place over a relatively short period of time such as 12 months. For example, Corporation A purchased 30 percent of the common stock of Corporation W (the only class of stock outstanding) for cash in 1939. On March 1, 1955, Corporation A offers to exchange its own voting stock for all the stock of Corporation W tendered within 6 months from the date of the offer. Within the 6-months' period Corporation A acquires an additional 60 percent of stock of Corporation W solely for its own voting stock, so that it owns 90 percent of the stock of Corporation W. No gain or loss is recognized with respect to the exchanges of stock of Corporation A for stock of Corporation W. For this purpose, it is immaterial whether such exchanges occurred before Corporation A acquired control (80 percent) of Corporation W or after such control was acquired. If Corporation A had acquired 80 percent of the stock of Corporation W for cash in 1939, it could likewise acquire some or all of the remainder of such stock solely in exchange for its own voting stock without recognition of gain or loss.

(d) In order to qualify as a reorganization under section 368(a)(1)(C), the transaction must be one described in subparagraph (1) or (2) of this paragraph:

(1) One corporation must acquire substantially all the properties of another corporation solely in exchange for all or a part of its own voting stock, or solely in exchange for all or a part of

the voting stock of a corporation which is in control of the acquiring corporation. For example, Corporation P owns all the stock of Corporation A. All the properties of Corporation W are transferred to Corporation A either solely in exchange for voting stock of Corporation P or solely in exchange for less than 80 percent of the voting stock of Corporation A. Either of such transactions constitutes a reorganization under section 368(a)(1)(C). However, if the properties of Corporation W are acquired in exchange for voting stock of both Corporation P and Corporation A, the transaction will not constitute a reorganization under section 368(a)(1)(C). In determining whether the exchange meets the requirement of “solely for voting stock”, the assumption by the acquiring corporation of liabilities of the transferor corporation, or the fact that property acquired from the transferor corporation is subject to a liability, shall be disregarded. Though such an assumption does not prevent an exchange from being solely for voting stock for the purposes of the definition of a reorganization contained in section 368(a)(1)(C), it may in some cases, however, so alter the character of the transaction as to place the transaction outside the purposes and assumptions of the reorganization provisions. Section 368(a)(1)(C) does not prevent consideration of the effect of an assumption of liabilities on the general character of the transaction but merely provides that the requirement that the exchange be solely for voting stock is satisfied if the only additional consideration is an assumption of liabilities.

(2) One corporation:

(i) Must acquire substantially all of the properties of another corporation in such manner that the acquisition would qualify under (1) above, but for the fact that the acquiring corporation exchanges money, or other property in addition to such voting stock, and

(ii) Must acquire solely for voting stock (either of the acquiring corporation or of a corporation which is in control of the acquiring corporation) properties of the other corporation having a fair market value which is at least 80 percent of the fair market

value of all the properties of the other corporation.

(3) For the purposes of subparagraph (2)(ii) only, a liability assumed or to which the properties are subject is considered money paid for the properties. For example, Corporation A has properties with a fair market value of \$100,000 and liabilities of \$10,000. In exchange for these properties, Corporation Y transfers its own voting stock, assumes the \$10,000 liabilities, and pays \$8,000 in cash. The transaction is a reorganization even though a part of the properties of Corporation A is acquired for cash. On the other hand, if the properties of Corporation A worth \$100,000, were subject to \$50,000 in liabilities, an acquisition of all the properties, subject to the liabilities, for any consideration other than solely voting stock would not qualify as a reorganization under this section since the liabilities alone are in excess of 20 percent of the fair market value of the properties. If the transaction would qualify under either subparagraph (1) or (2) of this paragraph and also under section 368(a)(1)(D), such transaction shall not be treated as a reorganization under section 368 (a)(1)(C).

(4)(i) For purposes of paragraphs (d)(1) and (2)(ii) of this section, prior ownership of stock of the target corporation by an acquiring corporation will not by itself prevent the solely for voting stock requirement of such paragraphs from being satisfied. In a transaction in which the acquiring corporation has prior ownership of stock of the target corporation, the requirement of paragraph (d)(2)(ii) of this section is satisfied only if the sum of the money or other property that is distributed in pursuance of the plan of reorganization to the shareholders of the target corporation other than the acquiring corporation and to the creditors of the target corporation pursuant to section 361(b)(3), and all of the liabilities of the target corporation assumed by the acquiring corporation (including liabilities to which the properties of the target corporation are subject), does not exceed 20 percent of the value of all of the properties of the target corporation. If, in connection with a potential

acquisition by an acquiring corporation of substantially all of a target corporation's properties, the acquiring corporation acquires the target corporation's stock for consideration other than the acquiring corporation's own voting stock (or voting stock of a corporation in control of the acquiring corporation if such stock is used in the acquisition of the target corporation's properties), whether from a shareholder of the target corporation or the target corporation itself, such consideration is treated, for purposes of paragraphs (d)(1) and (2) of this section, as money or other property exchanged by the acquiring corporation for the target corporation's properties. Accordingly, the transaction will not qualify under section 368(a)(1)(C) unless, treating such consideration as money or other property, the requirements of section 368(a)(2)(B) and paragraph (d)(2)(ii) of this section are met. The determination of whether there has been an acquisition in connection with a potential reorganization under section 368(a)(1)(C) of a target corporation's stock for consideration other than an acquiring corporation's own voting stock (or voting stock of a corporation in control of the acquiring corporation if such stock is used in the acquisition of the target corporation's properties) will be made on the basis of all of the facts and circumstances.

(ii) The following examples illustrate the principles of this paragraph (d)(4):

*Example 1.* Corporation P (P) holds 60 percent of the Corporation T (T) stock that P purchased several years ago in an unrelated transaction. T has 100 shares of stock outstanding. The other 40 percent of the T stock is owned by Corporation X (X), an unrelated corporation. T has properties with a fair market value of \$110 and liabilities of \$10. T transfers all of its properties to P. In exchange, P assumes the \$10 of liabilities, and transfers to T \$30 of P voting stock and \$10 of cash. T distributes the P voting stock and \$10 of cash to X and liquidates. The transaction satisfies the solely for voting stock requirement of paragraph (d)(2)(ii) of this section because the sum of \$10 of cash paid to X and the assumption by P of \$10 of liabilities does not exceed 20% of the value of the properties of T.

*Example 2.* The facts are the same as in *Example 1* except that P purchased the 60 shares of T for \$60 in cash in connection with the acquisition of T's assets. The transaction

does not satisfy the solely for voting stock requirement of paragraph (d)(2)(ii) of this section because P is treated as having acquired all of the T assets for consideration consisting of \$70 of cash, \$10 of liability assumption and \$30 of P voting stock, and the sum of \$70 of cash and the assumption by P of \$10 of liabilities exceeds 20% of the value of the properties of T.

(iii) This paragraph (d)(4) applies to transactions occurring after December 31, 1999, unless the transaction occurs pursuant to a written agreement that is (subject to customary conditions) binding on that date and at all times thereafter.

(e) A "recapitalization", and therefore a reorganization, takes place if, for example:

(1) A corporation with \$200,000 par value of bonds outstanding, instead of paying them off in cash, discharges them by issuing preferred shares to the bondholders;

(2) There is surrendered to a corporation for cancellation 25 percent of its preferred stock in exchange for no par value common stock;

(3) A corporation issues preferred stock, previously authorized but unissued, for outstanding common stock;

(4) An exchange is made of a corporation's outstanding preferred stock, having certain priorities with reference to the amount and time of payment of dividends and the distribution of the corporate assets upon liquidation, for a new issue of such corporation's common stock having no such rights;

(5) An exchange is made of an amount of a corporation's outstanding preferred stock with dividends in arrears for other stock of the corporation. However, if pursuant to such an exchange there is an increase in the proportionate interest of the preferred shareholders in the assets or earnings and profits of the corporation, then under § 1.305-7(c)(2), an amount equal to the lesser of (i) the amount by which the fair market value or liquidation preference, whichever is greater, of the stock received in the exchange (determined immediately following the recapitalization) exceeds the issue price of the preferred stock surrendered, or (ii) the amount of the dividends in arrears, shall be treated under section



305(c) as a deemed distribution to which sections 305(b)(4) and 301 apply.

(f) The term *a party to a reorganization* includes a corporation resulting from a reorganization, and both corporations, in a transaction qualifying as a reorganization where one corporation acquires stock or properties of another corporation. If a transaction otherwise qualifies as a reorganization, a corporation remains a party to the reorganization even though stock or assets acquired in the reorganization are transferred in a transaction described in paragraph (k) of this section. If a transaction otherwise qualifies as a reorganization, a corporation shall not cease to be a party to the reorganization solely by reason of the fact that part or all of the assets acquired in the reorganization are transferred to a partnership in which the transferor is a partner if the continuity of business enterprise requirement is satisfied. See § 1.368-1(d). The preceding three sentences apply to transactions occurring after January 28, 1998, except that they do not apply to any transaction occurring pursuant to a written agreement which is binding on January 28, 1998, and at all times thereafter. A corporation controlling an acquiring corporation is a party to the reorganization when the stock of such controlling corporation is used in the acquisition of properties. Both corporations are parties to the reorganization if, under statutory authority, Corporation A is merged into Corporation B. All three of the corporations are parties to the reorganization if, pursuant to statutory authority, Corporation C and Corporation D are consolidated into Corporation E. Both corporations are parties to the reorganization if Corporation F transfers substantially all its assets to Corporation G in exchange for all or a part of the voting stock of Corporation G. All three corporations are parties to the reorganization if Corporation H transfers substantially all its assets to Corporation K in exchange for all or a part of the voting stock of Corporation L, which is in control of Corporation K. Both corporations are parties to the reorganization if Corporation M transfers all or part of its assets to Corporation N in exchange for all or a part of the stock and securities of Corporation N,

but only if (1) immediately after such transfer, Corporation M, or one or more of its shareholders (including persons who were shareholders immediately before such transfer), or any combination thereof, is in control of Corporation N, and (2) in pursuance of the plan, the stock and securities of Corporation N are transferred or distributed by Corporation M in a transaction in which gain or loss is not recognized under section 354 or 355, or is recognized only to the extent provided in section 356. Both Corporation O and Corporation P, but not Corporation S, are parties to the reorganization if Corporation O acquires stock of Corporation P from Corporation S in exchange solely for a part of the voting stock of Corporation O, if (1) the stock of Corporation P does not constitute substantially all of the assets of Corporation S, (2) Corporation S is not in control of Corporation O immediately after the acquisition, and (3) Corporation O is in control of Corporation P immediately after the acquisition. If a transaction otherwise qualifies as a reorganization under section 368(a)(1)(B) or as a reverse triangular merger (as defined in § 1.358-6(b)(2)(iii)), the target corporation (in the case of a transaction that otherwise qualifies as a reorganization under section 368(a)(1)(B)) or the surviving corporation (in the case of a transaction that otherwise qualifies as a reverse triangular merger) remains a party to the reorganization even though its stock or assets are transferred in a transaction described in paragraph (k) of this section. If a transaction otherwise qualifies as a forward triangular merger (as defined in § 1.358-6(b)(2)(i)), a triangular B reorganization (as defined in § 1.358-6(b)(2)(iv)), a triangular C reorganization (as defined in § 1.358-6(b)(2)(ii)), or a reorganization under section 368(a)(1)(G) by reason of section 368(a)(2)(D), the acquiring corporation remains a party to the reorganization even though its stock is transferred in a transaction described in paragraph (k) of this section. The two preceding sentences apply to transactions occurring on or after October 25, 2007, except that they do not apply to any transaction occurring pursuant to a written

agreement which is binding before October 25, 2007, and at all times after that.

(g) The term *plan of reorganization* has reference to a consummated transaction specifically defined as a reorganization under section 368(a). The term is not to be construed as broadening the definition of *reorganization* as set forth in section 368(a), but is to be taken as limiting the nonrecognition of gain or loss to such exchanges or distributions as are directly a part of the transaction specifically described as a reorganization in section 368(a). Moreover, the transaction, or series of transactions, embraced in a plan of reorganization must not only come within the specific language of section 368(a), but the readjustments involved in the exchanges or distributions effected in the consummation thereof must be undertaken for reasons germane to the continuance of the business of a corporation a party to the reorganization. Section 368(a) contemplates genuine corporate reorganizations which are designed to effect a readjustment of continuing interests under modified corporate forms.

(h) As used in section 368, as well as in other provisions of the Internal Revenue Code, if the context so requires, the conjunction “or” denotes both the conjunctive and the disjunctive, and the singular includes the plural. For example, the provisions of the statute are complied with if “stock and securities” are received in exchange as well as if “stock or securities” are received.

(i) [Reserved]

(j)(1) This paragraph (j) prescribes rules relating to the application of section 368 (a)(2)(E).

(2) Section 368(a)(2)(E) does not apply to a consolidation.

(3) A transaction otherwise qualifying under section 368(a)(1)(A) is not disqualified by reason of the fact that stock of a corporation (the controlling corporation) which before the merger was in control of the merged corporation is used in the transaction, if the conditions of section 368(a)(2)(E) are satisfied. Those conditions are as follows:

(i) In the transaction, shareholders of the surviving corporation must surrender stock in exchange for voting

stock of the controlling corporation. Further, the stock so surrendered must constitute control of the surviving corporation. Control is defined in section 368(c). The amount of stock constituting control is measured immediately before the transaction. For purposes of this subdivision (i), stock in the surviving corporation which is surrendered in the transaction (by any shareholder except the controlling corporation) in exchange for consideration furnished by the surviving corporation (and not by the controlling corporation of the merged corporation) is considered not to be outstanding immediately before the transaction. For effect on “substantially all” test of consideration furnished by the surviving corporation, see paragraph (j)(3)(iii) of this section.

(ii) Except as provided in paragraph (k) of this section, the controlling corporation must control the surviving corporation immediately after the transaction.

(iii) After the transaction, the surviving corporation must hold substantially all of its own properties and substantially all of the properties of the merged corporation (other than stock of the controlling corporation distributed in the transaction). The surviving corporation may transfer such properties as provided in paragraph (k) of this section. After the transaction, except as provided in paragraph (k)(2) of this section, the surviving corporation must hold substantially all of its own properties and substantially all of the properties of the merged corporation (other than stock of the controlling corporation distributed in the transaction). The term *substantially all* has the same meaning as in section 368(a)(1)(C). The “substantially all” test applies separately to the merged corporation and to the surviving corporation. In applying the “substantially all” test to the surviving corporation, consideration furnished in the transaction by the surviving corporation in exchange for its stock is property of the surviving corporation which it does not hold after the transaction. In applying the “substantially all” test to the merged corporation, assets transferred from the controlling corporation to the merged corporation

in pursuance of the plan of reorganization are not taken into account. Thus, for example, money transferred from the controlling corporation to the merged corporation to be used for the following purposes is not taken into account for purposes of the “substantially all” test:

(A) To pay additional consideration to shareholders of the surviving corporation;

(B) To pay dissenting shareholders of the surviving corporation;

(C) To pay creditors of the surviving corporation;

(D) To pay reorganization expenses; or

(E) To enable the merged corporation to satisfy state minimum capitalization requirements (where the money is returned to the controlling corporation as part of the transaction).

(iv) Paragraph (j)(3)(ii) and the first two sentences of paragraph (j)(3)(iii) of this section apply to transactions occurring on or after October 25, 2007, except that they do not apply to any transaction occurring pursuant to a written agreement which is binding before October 25, 2007, and at all times thereafter. The remainder of paragraph (j)(3)(iii) of this section applies to transactions occurring after January 28, 1998, except that it does not apply to any transaction occurring pursuant to a written agreement which is binding on January 28, 1998, and at all times after that.

(4) The controlling corporation may assume liabilities of the surviving corporation without disqualifying the transaction under section 368(a)(2)(E). An assumption of liabilities of the surviving corporation by the controlling corporation is a contribution to capital by the controlling corporation to the surviving corporation. If, in pursuance of the plan of reorganization, securities of the surviving corporation are exchanged for securities of the controlling corporation, or for other securities of the surviving corporation, see sections 354 and 356.

(5) In applying section 368(a)(2)(E), it makes no difference if the merged corporation is an existing corporation, or is formed immediately before the merger, in anticipation of the merger, or after preliminary steps have been

taken to otherwise acquire control of the surviving corporation.

(6) The following examples illustrate the application of this paragraph (j). In each of the examples, Corporation P owns all of the stock of Corporation S and, except as otherwise stated, Corporation T has outstanding 1,000 shares of common stock and no shares of any other class. In each of the examples, it is also assumed that the transaction qualifies under section 368(a)(1)(A) if the conditions of section 368(a)(2)(E) are satisfied.

*Example 1.* P owns no T stock. On January 1, 1981, S merges into T. In the merger, T's shareholders surrender 950 shares of common stock in exchange for P voting stock. The holders of the other 50 shares (who dissent from the merger) are paid in cash with funds supplied by P. After the transaction, T holds all of its own assets and all of S's assets. Based on these facts, the transaction qualifies under section 368(a)(1)(A) by reason of the application of section 368(a)(2)(E). In the transaction, former shareholders of T surrender, in exchange for P voting stock, an amount of T stock (950/1,000 shares or 95 percent) which constitutes control of T.

*Example 2.* The facts are the same as in *Example 1* except that holders of 100 shares in corporation T, who dissented from the merger, are paid in cash with funds supplied by T (and not by P or S) and in the merger, T's remaining shareholders surrender 720 shares of common stock in exchange for P voting stock and 180 shares of common stock for cash supplied by P. The requirements of section 368(a)(2)(E)(ii) are satisfied since, in the transaction, former shareholders of T surrender, in exchange for P voting stock, an amount of T stock (720/900 shares or 80 percent) which constitutes control of T. The T stock surrendered in exchange for consideration furnished by T is not considered outstanding for purposes of determining whether the amount of T stock surrendered by T shareholders for P stock constitutes control of T.

*Example 3.* T has outstanding 1,000 shares of common stock, 100 shares of nonvoting preferred stock, and no shares of any other class. On January 1, 1981, S merges into T. Prior to the merger, as part of the transaction, T distributes its own cash in redemption of the 100 shares of preferred stock. In the transaction, T's remaining shareholders surrender their 1,000 shares of common stock in exchange for P voting stock. The requirements of section 368(a)(2)(E)(ii) are satisfied since, in the transaction, former shareholders of T surrender, in exchange for P voting stock, an amount of T stock (1,000/1,000 shares or 100 percent) which constitutes

control of T. The preferred stock surrendered in exchange for consideration furnished by T is not considered outstanding for purposes of determining whether the amount of T stock surrendered by T shareholders for P stock constitutes control of T. However, the consideration furnished by T for its stock is property of T which T does not hold after the transaction for purposes of the substantially all test in paragraph (j)(3)(iii) of this section.

*Example 4.* On January 1, 1971, P purchased 201 shares of T's stock. On January 1, 1981, S merges into T. In the merger, T's shareholders (other than P) surrender 799 shares of T stock in exchange for P voting stock. Based on these facts, in the transaction, former shareholders of T do not surrender, in exchange for P voting stock, an amount of T stock which constitutes control of T (799/1,000 shares being less than 80 percent). Therefore, the transaction does not qualify under section 368(a)(1)(A). However, if S is a transitory corporation, formed solely for purposes of effectuating the transaction, the transaction may qualify as a reorganization described in section 368(a)(1)(B) provided all of the applicable requirements are satisfied.

*Example 5.* On January 1, 1971, P purchased 200 shares of T's stock. On January 1, 1981, S merges into T. Prior to the merger, as part of the transaction, T distributes its own cash in redemption of 1 share of T stock from a T shareholder other than P. In the merger, T's remaining shareholders (other than P) surrender 799 shares of T stock in exchange for P voting stock. Based on these facts, in the transaction, former shareholders of T do not surrender, in exchange for P voting stock, an amount of T stock which constitutes control of T (799/999 shares being less than 80 percent). Therefore, the transaction does not qualify under section 368(a)(1)(A). However, if S is a transitory corporation, formed for purposes of effectuating the transaction, the transaction may qualify as a reorganization described in section 368(a)(1)(B) provided all of the applicable requirements are satisfied.

*Example 6.* The stock of S has a value of \$25,000. The stock of T has a value of \$75,000. On January 1, 1984, S merges into T. In the merger, T's shareholders surrender all of their T stock in exchange for P voting stock. After the transaction, T holds all of its own assets and all of S's assets. Based on these facts, the transaction qualifies under section 368(a)(1)(A) by reason of the application of section 368(a)(2)(E). In the transaction, former shareholders of T surrender, in exchange for P voting stock, an amount of T stock (1,000/1,000 shares or 100 percent) which constitutes control of T. The stock of T received by P in exchange for P's prior interest in S is not taken into account for purposes of section 368(a)(2)(E)(ii) since the amount of T stock constituting control of T is measured before the transaction.

*Example 7.* The stock of T has a value of \$75,000. On January 1, 1984, S merges into T. In the merger, T's shareholders surrender all of their T stock in exchange for P voting stock. As part of the transaction, P contributes \$25,000 to T in exchange for new shares of T stock. None of the cash received by T is distributed or otherwise paid out to former T shareholders. After the transaction, T holds all of its own assets and all of S's assets. Based on these facts, the transaction qualifies under section 368(a)(1)(A) by reason of the application of section 368(a)(2)(E). In the transaction, former shareholders of T surrender, in exchange for P voting stock, an amount of T stock (1,000/1,000 shares or 100 percent) which constitutes control of T. The T stock received by P in exchange for its contribution to T is not taken into account for purposes of section 368(a)(2)(E)(ii) since the amount of T stock constituting control of T is measured before the transaction.

*Example 8.* The facts are the same as in *Example 7* except that, as part of the transaction, corporation R, instead of P, contributes \$25,000 to T in exchange for T stock. Based on these facts, the transaction does not qualify under section 368(a)(1)(A) by reason of section 368(a)(2)(E) since P does not control T immediately after the transaction.

*Example 9.* T stock has a value of \$75,000. P owns 500 shares ( $\frac{1}{2}$ ) of that stock with a value of \$37,500. The stock of S has a value of \$125,000. On January 1, 1984, S merges into T. In the merger, T's shareholders (other than P) surrender their T stock in exchange for P voting stock. Based on these facts, in the transaction, former shareholders of T do not surrender, in exchange for P voting stock, an amount of T stock which constitutes control of T (500/1,000 shares being less than 80 percent). Therefore, the transaction does not qualify under section 368(a)(1)(A). The stock of T received by P in exchange for P's prior interest in S does not contribute to satisfaction of the requirement of section 368(a)(2)(E)(ii).

(k) *Certain transfers of assets or stock in reorganizations—(1) General rule.* A transaction otherwise qualifying as a reorganization under section 368(a) shall not be disqualified or recharacterized as a result of one or more subsequent transfers (or successive transfers) of assets or stock, provided that the requirements of § 1.368-1(d) are satisfied and the transfer(s) are described in either paragraph (k)(1)(i) or (k)(1)(ii) of this section. However, this paragraph (k) shall not apply to a transfer to the former shareholders of the acquired corporation (other than a former shareholder that is also the acquiring corporation) or the surviving

corporation, as the case may be, to the extent it constitutes the receipt of consideration for a proprietary interest in the acquired corporation or the surviving corporation, as the case may be. Similarly, this paragraph (k) shall not apply to a transfer by the former shareholders of the acquired corporation (other than a former shareholder that is also the acquiring corporation) or the surviving corporation, as the case may be, of consideration initially received in the potential reorganization to the issuing corporation or a person related to the issuing corporation (see definition of “related person” in § 1.368-1(e)).

(i) *Distributions.* One or more distributions to shareholders (including distribution(s) that involve the assumption of liabilities) are described in this paragraph (k)(1)(i) if—

(A) The property distributed consists of—

(1) Assets of the acquired corporation, the acquiring corporation, or the surviving corporation, as the case may be, or an interest in an entity received in exchange for such assets in a transfer described in paragraph (k)(1)(ii) of this section;

(2) Stock of the acquired corporation provided that such distribution(s) of stock do not cause the acquired corporation to cease to be a member of the qualified group (as defined in § 1.368-1(d)(4)(ii)); or

(3) A combination thereof; and

(B) The aggregate of such distributions does not consist of—

(1) An amount of assets of the acquired corporation, the acquiring corporation (disregarding assets held prior to the potential reorganization), or the surviving corporation (disregarding assets of the merged corporation), as the case may be, that would result in a liquidation of such corporation for Federal income tax purposes; or

(2) All of the stock of the acquired corporation that was acquired in the transaction.

(ii) *Transfers Other Than Distributions.* One or more other transfers are described in this paragraph (k)(1)(ii) if—

(A) The transfer(s) do not consist of one or more distributions to shareholders;

(B) The property transferred consists of—

(1) Part or all of the assets of the acquired corporation, the acquiring corporation, or the surviving corporation, as the case may be;

(2) Part or all of the stock of the acquired corporation, the acquiring corporation, or the surviving corporation, as the case may be, provided that such transfer(s) of stock do not cause such corporation to cease to be a member of the qualified group (as defined in § 1.368-1(d)(4)(ii)); or

(3) A combination thereof; and

(C) The acquired corporation, the acquiring corporation, or the surviving corporation, as the case may be, does not terminate its corporate existence for Federal income tax purposes in connection with the transfer(s).

(2) *Examples.* The following examples illustrate the application of this paragraph (k). Except as otherwise noted, P is the issuing corporation, and T is an unrelated target corporation. All corporations have only one class of stock outstanding. T operates a bakery that supplies delectable pastries and cookies to local retail stores. The acquiring corporate group produces a variety of baked goods for nationwide distribution. Except as otherwise noted, P owns all of the stock of S-1 and 80 percent of the stock of S-4, S-1 owns 80 percent of the stock of S-2 and 50 percent of the stock of S-5, S-2 owns 80 percent of the stock of S-3, and S-4 owns the remaining 50 percent of the stock of S-5. The examples are as follows:

*Example 1. Transfers of acquired assets to members of the qualified group after a reorganization under section 368(a)(1)(C).* (i) *Facts.* Pursuant to a plan of reorganization, T transfers all of its assets to S-1 solely in exchange for P stock, which T distributes to its shareholders, and S-1's assumption of T's liabilities. In addition, pursuant to the plan, S-1 transfers all of the T assets to S-2, and S-2 transfers all of the T assets to S-3.

(ii) *Analysis.* Under this paragraph (k), the transaction, which otherwise qualifies as a reorganization under section 368(a)(1)(C), is not disqualified by the successive transfers of all of the T assets to S-2 and from S-2 to S-3 because the transfers are not one or more distributions to shareholders, the transfers consist of part or all of the assets of the acquiring corporation, the acquiring corporation does not terminate its corporate

existence for Federal income tax purposes in connection with the transfers, and the transaction satisfies the requirements of § 1.368-1(d).

*Example 2. Distribution of acquired assets to a member of the qualified group after a reorganization under section 368(a)(1)(C).* (i) *Facts.* Pursuant to a plan of reorganization, T transfers all of its assets to S-1 solely in exchange for P stock, which T distributes to its shareholders, and S-1's assumption of T's liabilities. In addition, pursuant to the plan, S-1 distributes half of the T assets to P, and P assumes half of the T liabilities.

(ii) *Analysis.* Under this paragraph (k), the transaction, which otherwise qualifies as a reorganization under section 368(a)(1)(C), is not disqualified by the distribution of half of the T assets from S-1 to P, or P's assumption of half of the T liabilities from S-1, because the distribution consists of assets of the acquiring corporation, the distribution does not consist of an amount of S-1's assets that would result in a liquidation of S-1 for Federal income tax purposes (disregarding S-1's assets held prior to the acquisition of T), and the transaction satisfies the requirements of § 1.368-1(d).

*Example 3. Indirect distribution of acquired assets to a member of the qualified group after a reorganization under section 368(a)(1)(C).* (i) *Facts.* The facts are the same as *Example 2*, except that, instead of S-1 distributing half of the T assets to P and having P assume half of the T liabilities, S-1 contributes half of the T assets to newly formed S-6, S-6 assumes half of the T liabilities, and S-1 distributes all of the S-6 stock to P.

(ii) *Analysis.* Under this paragraph (k), the transaction, which otherwise qualifies as a reorganization under section 368(a)(1)(C), is not disqualified by the transfer of half of the T assets to S-6 and the distribution of the S-6 stock to P because the transfer of half of the T assets to S-6 is described in paragraph (k)(1)(ii) of this section, the distribution of the S-6 stock to P is an indirect distribution of assets of the acquiring corporation, the distribution does not consist of an amount of S-1's assets that would result in a liquidation of S-1 for Federal income tax purposes (disregarding S-1's assets held prior to the acquisition of T), and the transaction satisfies the requirements of § 1.368-1(d).

*Example 4. Distribution of acquired stock to a controlled partnership after a reorganization under section 368(a)(1)(B).* (i) *Facts.* P owns 80 percent of the stock of S-1, and an 80-percent interest in PRS, a partnership. S-4 owns the remaining 20-percent interest in PRS. PRS owns the remaining 20 percent of the stock of S-1. Pursuant to a plan of reorganization, the T shareholders transfer all of their T stock to S-1 solely in exchange for P stock. In addition, pursuant to the plan, S-1 distributes 90 percent of the T stock to PRS in

redemption of 5 percent of the stock of S-1 owned by PRS.

(ii) *Analysis.* Under this paragraph (k), the transaction, which otherwise qualifies as a reorganization under section 368(a)(1)(B), is not disqualified by the distribution of 90 percent of the T stock from S-1 to PRS because the distribution consists of less than all of the stock of the acquired corporation that was acquired in the transaction, the distribution does not cause T to cease to be a member of the qualified group (as defined in § 1.368-1(d)(4)(ii)), and the transaction satisfies the requirements of § 1.368-1(d).

*Example 5. Transfer of acquired stock to a non-controlled partnership.* (i) *Facts.* Pursuant to a plan, the T shareholders transfer all of their T stock to S-1 solely in exchange for P stock. In addition, as part of the plan, T distributes half of its assets to S-1, S-1 assumes half of the T liabilities, and S-1 transfers the T stock to S-2. S-2 and U, an unrelated corporation, form a new partnership, PRS. Immediately thereafter, S-2 transfers all of the T stock to PRS in exchange for a 50 percent interest in PRS, and U transfers cash to PRS in exchange for a 50 percent interest in PRS.

(ii) *Analysis.* Under this paragraph (k), the transaction, which otherwise qualifies as a reorganization under section 368(a)(1)(B), is not disqualified by the distribution of half of the T assets from T to S-1, or S-1's assumption of half of the T liabilities from T, because the distribution consists of assets of the acquired corporation, the distribution does not consist of an amount of T's assets that would result in a liquidation of T for Federal income tax purposes, and the transaction satisfies the requirements of § 1.368-1(d). Further, this paragraph (k) describes the transfer of the acquired stock from S-1 to S-2, but does not describe the transfer of the acquired stock from S-2 to PRS because such transfer causes T to cease to be a member of the qualified group (as defined in § 1.368-1(d)(4)(ii)). Therefore, the characterization of this transaction must be determined under the relevant provisions of law, including the step transaction doctrine. See § 1.368-1(a). The transaction fails to meet the control requirement of a reorganization described in section 368(a)(1)(B) because immediately after the acquisition of the T stock, the acquiring corporation does not have control of T.

*Example 6. Transfers of acquired assets to members of the qualified group after a reorganization under section 368(a)(1)(D).* (i) *Facts.* P owns all of the stock of T. Pursuant to a plan of reorganization, T transfers all of its assets to S-1 solely in exchange for S-1 stock, which T distributes to P, and S-1's assumption of T's liabilities. In addition, pursuant to the plan, S-1 transfers all of the T assets to S-2, and S-2 transfers all of the T assets to S-3.

(ii) *Analysis.* Under this paragraph (k), the transaction, which otherwise qualifies as a reorganization under section 368(a)(1)(D), is not disqualified by the successive transfers of all the T assets from S-1 to S-2 and from S-2 to S-3 because the transfers are not one or more distributions to shareholders, the transfers consist of part or all of the assets of the acquiring corporation, the acquiring corporation does not terminate its corporate existence for Federal income tax purposes in connection with the transfers, and the transaction satisfies the requirements of § 1.368-1(d).

*Example 7. Transfer of stock of the acquiring corporation to a member of the qualified group after a reorganization under section 368(a)(1)(A) by reason of section 368(a)(2)(D).* (i) *Facts.* Pursuant to a plan of reorganization, S-1 acquires all of the T assets in the merger of T into S-1. In the merger, the T shareholders receive solely P stock. Also, pursuant to the plan, P transfers all of the S-1 stock to S-4.

(ii) *Analysis.* Under this paragraph (k), the transaction, which otherwise qualifies as a reorganization under section 368(a)(1)(A) by reason of section 368(a)(2)(D), is not disqualified by the transfer of all of the S-1 stock to S-4 because the transfer is not a distribution to shareholders, the transfer consists of part or all of the stock of the acquiring corporation, the transfer does not cause S-1 to cease to be a member of the qualified group (as defined in § 1.368-1(d)(4)(ii)), the acquiring corporation does not terminate its corporate existence for Federal income tax purposes in connection with the transfer, and the transaction satisfies the requirements of § 1.368-1(d).

*Example 8. Transfer of acquired assets to a partnership after a reorganization under section 368(a)(1)(A) by reason of section 368(a)(2)(D).* (i) *Facts.* Pursuant to a plan of reorganization, S-1 acquires all of the T assets in the merger of T into S-1. In the merger, the T shareholders receive solely P stock. In addition, pursuant to the plan, S-1 transfers all of the T assets to PRS, a partnership in which S-1 owns a 33⅓-percent interest. PRS continues T's historic business. S-1 does not perform active and substantial management functions as a partner with respect to PRS' business.

(ii) *Analysis.* Under this paragraph (k), the transaction, which otherwise qualifies as a reorganization under section 368(a)(1)(A) by reason of section 368(a)(2)(D), is not disqualified by the transfer of T assets from S-1 to PRS because the transfer is not a distribution to shareholders, the transfer consists of part or all of the assets of the acquiring corporation, the acquiring corporation does not terminate its corporate existence for Federal income tax purposes in connection with the transfers, and the transaction satisfies the requirements of § 1.368-1(d).

*Example 9. Sale of acquired assets to a member of the qualified group after a reorganization under section 368(a)(1)(C).* (i) *Facts.* Pursuant to a plan of reorganization, T transfers all of its assets to S-1 in exchange for P stock, which T distributes to its shareholders, and S-1's assumption of T's liabilities. In addition, pursuant to the plan, S-1 sells all of the T assets to S-5 for cash equal to the fair market value of those assets.

(ii) *Analysis.* Under this paragraph (k), the transaction, which otherwise qualifies as a reorganization under section 368(a)(1)(C), is not disqualified by the sale of all of the T assets from S-1 to S-5 because the transfer is not a distribution to shareholders, the transfer consists of part or all of the assets of the acquiring corporation, the acquiring corporation does not terminate its corporate existence for Federal income tax purposes in connection with the transfer, and the transaction satisfies the requirements of § 1.368-1(d).

(3) *Effective/applicability dates.* This paragraph (k) applies to transactions occurring on or after *May 9, 2008*, except that it does not apply to any transaction occurring pursuant to a written agreement which is binding before *May 9, 2008*, and at all times after that.

(1) *Certain transactions treated as reorganizations described in section 368(a)(1)(D)*—(1) *General rule.* In order to qualify as a reorganization under section 368(a)(1)(D), a corporation (transferor corporation) must transfer all or part of its assets to another corporation (transferee corporation) and immediately after the transfer the transferor corporation, or one or more of its shareholders (including persons who were shareholders immediately before the transfer), or any combination thereof, must be in control of the transferee corporation; but only if, in pursuance of the plan, stock or securities of the transferee are distributed in a transaction which qualifies under section 354, 355, or 356.

(2) *Distribution requirement*—(i) *In general.* For purposes of paragraph (1)(1) of this section, a transaction otherwise described in section 368(a)(1)(D) will be treated as satisfying the requirements of sections 368(a)(1)(D) and 354(b)(1)(B) notwithstanding that there is no actual issuance of stock and/or securities of the transferee corporation if the same person or persons own, directly or

indirectly, all of the stock of the transferor and transferee corporations in identical proportions. In cases where no consideration is received or the value of the consideration received in the transaction is less than the fair market value of the transferor corporation's assets, the transferee corporation will be treated as issuing stock with a value equal to the excess of the fair market value of the transferor corporation's assets over the value of the consideration actually received in the transaction. In cases where the value of the consideration received in the transaction is equal to the fair market value of the transferor corporation's assets, the transferee corporation will be deemed to issue a nominal share of stock to the transferor corporation in addition to the actual consideration exchanged for the transferor corporation's assets. The nominal share of stock in the transferee corporation will then be deemed distributed by the transferor corporation to the shareholders of the transferor corporation, as part of the exchange for the stock of such shareholders. Where appropriate, the nominal share will be further transferred through chains of ownership to the extent necessary to reflect the actual ownership of the transferor and transferee corporations. Similar treatment to that of the preceding two sentences shall apply where the transferee corporation is treated as issuing stock with a value equal to the excess of the fair market value of the transferor corporation's assets over the value of the consideration actually received in the transaction.

(ii) *Attribution.* For purposes of paragraph (1)(2)(i) of this section, ownership of stock will be determined by applying the principles of section 318(a)(2) without regard to the 50 percent limitation in section 318(a)(2)(C). In addition, an individual and all members of his family described in section 318(a)(1) shall be treated as one individual.

(iii) *De minimis variations in ownership and certain stock not taken into account.* For purposes of paragraph (1)(2)(i) of this section, the same person or persons will be treated as owning, directly or indirectly, all of the stock of the transferor and transferee corporations in identical proportions notwith-

standing the fact that there is a de minimis variation in shareholder identity or proportionality of ownership. Additionally, for purposes of paragraph (1)(2)(i) of this section, stock described in section 1504(a)(4) is not taken into account.

(iv) *Exception.* Paragraph (1)(2) of this section does not apply to a transaction otherwise described in § 1.358-6(b)(2).

(3) *Examples.* The following examples illustrate the principles of paragraph (1) of this section. For purposes of these examples, each of A, B, C, and D is an individual, T is the acquired corporation, S is the acquiring corporation, P is the parent corporation, and each of S1, S2, S3, and S4 is a direct or indirect subsidiary of P. Further, all of the requirements of section 368(a)(1)(D) other than the requirement that stock or securities be distributed in a transaction to which section 354 or 356 applies are satisfied. The examples are as follows:

*Example 1.* A owns all the stock of T and S. The T stock has a fair market value of \$100x. T sells all of its assets to S in exchange for \$100x of cash and immediately liquidates. Because there is complete shareholder identity and proportionality of ownership in T and S, under paragraph (1)(2)(i) of this section, the requirements of sections 368(a)(1)(D) and 354(b)(1)(B) are treated as satisfied notwithstanding the fact that no S stock is issued. Pursuant to paragraph (1)(2)(i) of this section, S will be deemed to issue a nominal share of S stock to T in addition to the \$100x of cash actually exchanged for the T assets, and T will be deemed to distribute all such consideration to A. The transaction qualifies as a reorganization described in section 368(a)(1)(D).

*Example 2.* The facts are the same as in *Example 1* except that C, A's son, owns all of the stock of S. Under paragraph (1)(2)(ii) of this section, A and C are treated as one individual. Accordingly, there is complete shareholder identity and proportionality of ownership in T and S. Therefore, under paragraph (1)(2)(i) of this section, the requirements of sections 368(a)(1)(D) and 354(b)(1)(B) are treated as satisfied notwithstanding the fact that no S stock is issued. Pursuant to paragraph (1)(2)(i) of this section, S will be deemed to issue a nominal share of S stock to T in addition to the \$100x of cash actually exchanged for the T assets, and T will be deemed to distribute all such consideration to A. A will be deemed to transfer the nominal share of S stock to C. The transaction qualifies as a reorganization described in section 368(a)(1)(D).



*Example 3.* P owns all of the stock of S1 and S2. S1 owns all of the stock of S3, which owns all of the stock of T. S2 owns all of the stock of S4, which owns all of the stock of S. The T stock has a fair market value of \$70x. T sells all of its assets to S in exchange for \$70x of cash and immediately liquidates. Under paragraph (1)(2)(ii) of this section, there is indirect, complete shareholder identity and proportionality of ownership in T and S. Accordingly, the requirements of sections 368(a)(1)(D) and 354(b)(1)(B) are treated as satisfied notwithstanding the fact that no S stock is issued. Pursuant to paragraph (1)(2)(i) of this section, S will be deemed to issue a nominal share of S stock to T in addition to the \$70x of cash actually exchanged for the T assets, and T will be deemed to distribute all such consideration to S3. S3 will be deemed to distribute the nominal share of S stock to S1, which, in turn, will be deemed to distribute the nominal share of S stock to P. P will be deemed to transfer the nominal share of S stock to S2, which, in turn, will be deemed to transfer such share of S stock to S4. The transaction qualifies as a reorganization described in section 368(a)(1)(D).

*Example 4.* A, B, and C own 34%, 33%, and 33%, respectively, of the stock of T. The T stock has a fair market value of \$100x. A, B, and C each own 33% of the stock of S. D owns the remaining 1% of the stock of S. T sells all of its assets to S in exchange for \$100x of cash and immediately liquidates. For purposes of determining whether the distribution requirement of sections 368(a)(1)(D) and 354(b)(1)(B) is met, under paragraph (1)(2)(iii) of this section, D's ownership of a de minimis amount of stock of S is disregarded and the transaction is treated as if there is complete shareholder identity and proportionality of ownership in T and S. Because there is complete shareholder identity and proportionality of ownership in T and S, under paragraph (1)(2)(i) of this section, the requirements of sections 368(a)(1)(D) and 354(b)(1)(B) are treated as satisfied notwithstanding the fact that no S stock is issued. Pursuant to paragraph (1)(2)(i) of this section, S will be deemed to issue a nominal share of S stock to T in addition to the \$100x of cash actually exchanged for the T assets. T will be deemed to distribute all such consideration to A, B, and C, and the nominal S stock will be deemed transferred among the S shareholders to the extent necessary to reflect their actual ownership of S. The transaction qualifies as a reorganization described in section 368(a)(1)(D).

*Example 5.* The facts are the same as in *Example 4* except that A, B, and C own 34%, 33%, and 33%, respectively, of the common stock of T and S. D owns preferred stock in S described in section 1504(a)(4). For purposes of determining whether the distribution requirement of sections 368(a)(1)(D) and 354(b)(1)(B) is met, under paragraph (1)(2)(iii)

of this section, D's ownership of S stock described in section 1504(a)(4) is ignored and the transaction is treated as if there is complete shareholder identity and proportionality of ownership in T and S. Because there is complete shareholder identity and proportionality of ownership in T and S, under paragraph (1)(2)(i) of this section, the requirements of sections 368(a)(1)(D) and 354(b)(1)(B) are treated as satisfied notwithstanding the fact that no S stock is issued. Pursuant to paragraph (1)(2)(i) of this section, S will be deemed to issue a nominal share of S stock to T in addition to the \$100x of cash actually exchanged for the T assets, and T will be deemed to distribute all such consideration to A, B, and C. The transaction qualifies as a reorganization described in section 368(a)(1)(D).

*Example 6.* A and B each own 50% of the stock of T. The T stock has a fair market value of \$100x. B and C own 90% and 10%, respectively, of the stock of S. T sells all of its assets to S in exchange for \$100x of cash and immediately liquidates. Because complete shareholder identity and proportionality of ownership in T and S does not exist, paragraph (1)(2)(i) of this section does not apply. The requirements of sections 368(a)(1)(D) and 354(b)(1)(B) are not satisfied, and the transaction does not qualify as a reorganization described in section 368(a)(1)(D).

(4) *Effective/applicability date*—(i) *In general.* This section applies to transactions occurring on or after *December 18, 2009*. For rules regarding transactions occurring before *December 18, 2009*, see section 1.368-2T(1) as contained in 26 CFR part 1.

(ii) *Transitional rule.* A taxpayer may apply the provisions of these regulations to transactions occurring before *December 18, 2009*. However, the transferor corporation, the transferee corporation, any direct or indirect transferee of transferred basis property from either of the foregoing, and any shareholder of the transferor or transferee corporation may not apply the provisions of these regulations unless all such taxpayers apply the provisions of the regulations.

[T.D. 6500, 25 FR 11607, Nov. 26, 1960]

EDITORIAL NOTE: For FEDERAL REGISTER citations affecting § 1.368-2, see the List of CFR Sections Affected, which appears in the Finding Aids section of the printed volume and at [www.fdsys.gov](http://www.fdsys.gov).